

Commercial Leasing Newsletter

A COMMERCIAL LANDLORD'S RIGHT OF DISTRAINT - SOME PRACTICAL CONSIDERATIONS

In my previous Newsletter I summarized a Commercial Landlord's remedies for arrears of rent. I was pleasantly surprised that a number of readers contacted me to bring to my attention various pitfalls a Commercial Landlord needed to look out for in exercising one of the remedies I outlined, being the Commercial Landlord's right to distraint against a tenant's goods for arrears of rent.

The comments I received reinforced my perception that over the past few years a general level of discomfort has arisen with the exercise of this remedy, and a general mood seems to have developed that it is more trouble than it is worth.

There is no question that a Commercial Landlord who wants to rely on the right of distraint to collect rental arrears often has to tip toe through a minefield. However, this generalization does not mean that Landlords should easily give up this right. What follows is a summary of what makes the right of distress a powerful collection tool, and some practical considerations to keep in mind to avoid stepping on any mines.

The right of distraint is a powerful and extraordinary right because:

- a) It is enforceable strictly on a self help basis and arises implicitly from the Landlord and Tenant relationship. The Landlord does not need an express contractual right of distraint or a Court Order to carry it out. The Landlord, without using force, may attend on the rental premises and then follow a certain procedure for seizing and selling the tenant's goods;
- b) It does not have to be "preserved" or "perfected" as a pre-condition to enforcement by some form of registration;
- c) It arises immediately upon default and is exercisable without any advance notice to the tenant; and
- d) It has priority over the interest in the tenant's goods of secured creditors with security agreements that do not have title reservation clauses, like Chattel Mortgages and standard Bank General Security Agreements.

The following are some of the most common practical considerations for Landlords to keep in mind when exercising their right of distraint:

- a) It can only be exercised if there has been a default in payment of rent, and tenants often argue that they are not "late" in paying the rent because the Landlord, by its conduct, has "waived" the late payment of rent, or that there is no rent owing because the Landlord has failed to carry out its obligations under the Lease giving rise to a "set off" or "abatement" of rent;
- b) The goods of "third parties" on the rental premises cannot be seized and thus a Landlord may wrongfully seize someone else's goods;

The Landlord may seize the goods of the tenant or subtenant found on the rental premises. The *Commercial Tenancies Act* allows a subtenant in certain situations to avoid being distrained against by paying rent to the Landlord.

Goods on consignment, or leased, may not be seized. Goods subject to a Conditional Sales Contract may be seized, but the Landlord will be liable for the balance owing by the tenant and therefore a Landlord would only want to seize and sell such an asset if there is equity in it.

Goods subject to section 427 *Bank Act* security may not be seized because under the *Bank Act* title vests in the Bank, and the goods therefore are not owned by the tenant. There seems to be an exception to this if the arrears of rent arose before the *Bank Act* security was given;

- c) The right of distraint is lost if the Lease is terminated. If the locks of the rental premises are changed in carrying out the distraint, because it is physically impossible or too difficult to actually remove the goods being distrained, it is arguable the Lease has been terminated, unless the Landlord takes special care to make sure the tenant knows that on request it can easily access the premises and immediately provides access on request;
- d) The right of distraint is lost if the tenant becomes bankrupt before a sale is completed. Furthermore, if a distraint occurs within three months of a bankruptcy, and the tenant “allowed” the Landlord to distraint to prefer the Landlord over other creditors, the distraint may be set aside as a fraudulent preference;
- e) The Provincial Government for PST arrears, and the Federal Government for GST arrears and unremitted employee source deductions, have statutory deemed trust or super lien claims over the tenant’s goods in priority to the Landlord’s right of distraint. Furthermore, the *Retail Sales Tax Act* imposes an obligation on a Landlord to obtain a “clearance certificate” before any distraint sale, failing which the Landlord will be personally liable for the full amount of any PST arrears; and
- f) The Landlord has a duty to obtain “the best price obtainable” for the goods obtained.

Many of the risks associated with distraining can be overcome and made manageable. Each individual situation should be assessed to evaluate the risks and to determine any steps which may be taken to protect against these. For example, any possible “waiver” claim by a tenant may be precluded by a fresh demand for payment prior to distraining, a Landlord may be able to abandon its distraint and limit its exposure to its distraint costs if it appears there are numerous competing claims with priority over the Landlord, or if PST arrears turn out to exceed the value of the tenant’s assets the Provincial Government may agree to let the Landlord continue with its distraint and recover its costs out of the sale proceeds with the balance to be paid to the Government. These are only a few examples of the many ways to manage the risks involved in distraining, and Landlords should consider obtaining legal advice and the services of an experienced Bailiff in order to mitigate the many risks involved and to maximize recovery.

**If you have any questions about the rights of a commercial landlord,
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